No. 15797

In the United States Court of Appeals for the Ninth Circuit

MARC D. LEH AND L. WAIVE LEH, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

DAVID E. BROWN AND CHRISTOBEL H. BROWN, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petitions for Review of the Decisions of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (R. 23-35) are reported at 27 T.C. 892.

JURISDICTION

These petitions for review (R. 38-42) involve federal income taxes for the taxable year 1950. On April 23, 1954, the Commissioner of Internal Rev-

enue mailed to the taxpayers Marc D. Leh and L. Waive Leh notice of a deficiency in the total amount of $24,669.86 and to taxpayers David E. Brown and Christobel H. Brown, notice of a deficiency in the total amount of $24,669.86. (R. 5, 19.) Within 90 days thereafter and on July 16, 1954, taxpayers filed petiitons with the Tax Court for redetermination of the deficiencies under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 3, 4.) The decisions of the Tax Court were entered June 20, 1957. (R. 36, 37.) The case is brought to this Court by petitions for review filed September 16, 1957. (R. 38-42.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the cancellation of a contract under which taxpayers had the right to purchase a fixed amount of gasoline per month constituted a "sale or exchange" within the meaning of Section 117(a)(4) and (j) of the Internal Revenue Code of 1939, and thus entitles taxpayers to treat the consideration received for the cancellation as capital gain rather than ordinary income.

STATUTES INVOLVED

These appear in the Appendix, *infra*.

STATEMENT

The facts as found by the Tax Court (R. 24-30), some of which were stipulated (R. 14-18), may be briefly summarized as follows:

The Progress Company (hereinafter referred to as Progress) was a general partnership the members of which were taxpayers Marc D. Leh and David E. Brown [1] who shared profits and losses equally. It was formed in 1940 and was thereafter engaged in various businesses, including the marketing of petroleum products during the years 1947, 1948, 1949 and 1950. (R. 24-25.)

Olympic Refining Company (hereinafter referred to as Olympic) is a corporation also engaged in marketing petroleum products. On November 19, 1945, Olympic entered into a contract with General Petroleum Corporation (hereinafter referred to as General) pursuant to which Olympic was obligated to purchase its entire requirements of gasoline from General and the latter was obligated to supply Olympic's requirements of gasoline and other petroleum products up to a maximum of 3,500,000 gallons per month. This contract contained an expiration date of January 1, 1951, but it also provided for automatic extensions from year to year subject to termination upon six months notice by either party. In 1946 and 1947, Olmpic's purchases under this contract (hereinafter referred to as the General-Olympic contract), averaged 1,000,000 to 1,250,000 gallons per month. (R. 25.)

On January 28, 1948, Progress entered into a contract with Olympic (hereinafter referred to as the

[1] L. Waive Leh and Christobel H. Brown are the wives of the respective taxpayers named above and are parties herein solely because they filed returns with their husbands for the years involved. Consequently only Marc D. Leh and David E. Brown will be referred to as the taxpayers herein.

Progress-Olympic contract) which was set forth in two letters of that date. (R. 25.) One letter, from Olympic to Progress, read as follows (R. 25-26):

> We are pleased to submit below our proposal to serve you with your requirements of our gasoline.
>
> Your signature of acceptance acknowledges that you have read and are familiar with the terms and conditions of that certain agreement between Olympic Refining Company and the General Petroleum Corporation of California, dated November 19, 1945, and that the terms, amendments, conditions and provisions are incorporated herein by reference and made a part hereof to all intents and purposes as though the same were set forth in full, except that:
>
> 1. The quantity of gasoline will be two and one-quarter million gallons, 10% more or less, subject to our option;
>
> 2. The prices you will pay us will be one-half cents per gallon greater than the prices which are set forth in said agreement; and
>
> 3. Gasolines purchased hereunder will not be resold for delivery into the States of Washington and Oregon nor within the territory in the State of California which is embraced within exclusive distributor contracts with the Olympic Refining Company as follows: San Francisco, San Jose, Glendale, Pasadena, and San Diego.

The other letter, from Progress to Olympic, read as follows (R. 26-27):

> In consideration of the gasoline contract which we have entered into with your company as of this date, it is understood that, in the event the Olympic Refining Company extends and/or

> makes a contract for gasolines with the General Petroleum Corporation of California and/or any other supplier of petroleum products, The Progress Co. shall have an extension of its agreement on the same terms and conditions, with the exceptions noted in our agreement of this date.
>
> Likewise, if The Progress Co. should negotiate a contract for gasoline similar to the above referred to type of contract with the General Petroleum Corporation of California and/or any other supplier of petroleum products, The Progress Co. will pay to the Olympic Refining Company one-half (½¢) cent per gallon during the life of said contract.

Prior to the execution of the foregoing contract, Progress and Olympic had entered into a "Distributors Agreement" under which Progress was entitled to 350,000 gallons of gasoline per month. In 1948, this agreement was assigned by Progress to Olympic-Progress Oil Co., a corporation controlled by taxpayers. (R. 27.)

Between 1948, when the Progress-Olympic contract was executed, and 1950, the gasoline market expanded; by 1950, gasoline was in short supply in the Southern California area. General, in order to reduce its supply commitments, entered into negotiations with Olympic in 1950 to obtain a reduction of its commitment under the General-Olympic contract; Olympic, in turn, sought reduction or elimination of its commitment to Progress. (R. 27.)

On July 26, 1950, an agreement entitled "Mutual Termination Agreement" was entered into by Progress, as first party, Olympic-Progress Oil Company,

as second party, and Olympic, as third party. (R. 27-28.) This agreement, after referring to prior agreements of the parties, including the Progress-Olympic contract and the distributors agreement, provided in part as follows (R. 28-29):

> 1. Each and all of said agreements above described are hereby mutually declared to be cancelled and terminated as of the close of business on the 31st day of July, 1950 and declared to be of no further force or effect.
>
> 2. First Party and Second Party hereby release and discharge Third Party and General Petroleum Corporation of and from any and all duties, claims, liabilities or obligations arising out of or in connection with said agreements above described or otherwise.
>
> 3. Third Party releases and discharges First Party of and from any and all duties, claims, liabilities or obligations arising out of or in connection with said agreements above described or otherwise; excepting however, that Third Party does not release First Party of or from the following indebtedness:
>
> > (a) The indebtedness in the sum of $255,277.80 owed by First Party to Third Party as of the close of business on the 24th day of July, 1950, for petroleum products theretofore sold and delivered by Third Party to First Party; and
> >
> > (b) Any indebtedness of First Party to Third Party for petroleum products sold and delivered by Third Party to First Party up to and including the 31st day of July, 1950, computed at the same prices used in

the computation of said existing indebtedness described in subparagraph (a) above;

First Party agrees to pay said indebtedness or any remaining balance thereof to Third Party on or before the 3rd day of August, 1950.

* * * *

5. In consideration of the termination of said agreements, as provided in paragraph 1 hereinabove, and in consideration of the releases herein provided for, Third Party shall pay to First Party the sum of $183,330.50, and to Second Party the sum of $31,669.50; which said sums may, at the election of Third Party, be paid in cash to Second and Third Parties respectively, or be paid by crediting the said sums respectively against the respective indebtedness of First and Second Parties described in paragraphs 3 and 4 hereinabove, which election shall be made by Third Party on or before July 31st.

The sum of $183,330.50 was paid to Progress in 1950 by crediting that sum to its account with Olympic for gasoline previously purchased under the Progress-Olympic contract. (R. 29.)

On July 31, 1950, General and Olympic entered into an agreement providing for the termination of the General-Olympic contract, and on August 1, 1950, they executed a new agreement pursuant to which Olympic was entitled to purchase 1,750,000 gallons of gasoline per month. General paid Olympic approximately $235,000 when these agreements were executed. (R. 29.)

The sum of $183,330.50 was reported as long-term capital gain on the partnership return filed by Prog-

ress for 1950 and on the individual returns filed by taxpayers. (R. 29-30.) The Tax Court held that the agreement of July 26, 1950, was not intended to effect a sale by Progress to Olympic of the former's rights under the Progress-Olympic contract, but was intended to terminate and cancel those rights. It held that under that contract, the rights of Progress "came to an end and vanished" and that there was no sale or exchange necessary as a basis for a capital gain. The determination of the Commissioner that the amount received under the agreement of July 26, 1950 was ordinary income was accordingly sustained. (R. 30-35.)

SUMMARY OF ARGUMENT

This case involves the effect of the cancellation of a contract under which taxpayers' partnership (Progress) was entitled to purchased 2,250,000 gallons of gasoline per month, and the treatment to be accorded the lump-sum payment received by taxpayers as consideration for such cancellation. The decision of the Tax Court that the sum received is taxable as ordinary income because the cancellation transaction did not constitute a "sale or exchange" of property, and is thus not capital gain, is supported by abundant judicial authority. The cancellation of a simple contract right, here the right to purchase a stipulated quantity of gasoline, does not effect a transfer or "sale or exchange" of such right to the seller. The cancellation agreement effects a destruction of the duty of the seller and the rights of the purchaser. The rights of the taxpayers (purchasers) came to an end and disappeared.

Moreover, the consideration received by taxpayers for the release of their partnership's rights to purchase gasoline was in essence but a substitute for the resale profits (ordinary income) which taxpayers would have realized if the contracts had been fully performed, instead of terminated. In holding that the amount received constituted ordinary income to taxpayers, the Tax Court properly distinguished between cases involving releases of simple contract rights and those involving surrender of more substantial property rights, such as the leasehold interest of a tenant. The Tax Court also examined the circumstances attendant to the execution of the cancellation agreement and correctly concluded that the parties intended to effect a cancellation and termination of the contract rights, not a transfer of such rights by taxpayers (Progress) to Olympic.

ARGUMENT

The Cancellation of Taxpayers' Supply Contract Was Not A Sale Or Exchange Within the Meaning of Section 117(a)(4) and (j) of the Internal Revenue Code of 1939, and the Amount Received for the Cancellation Was Properly Held Taxable As Ordinary Income Rather Than As Capital Gain

The sole question presented in this case is whether the amount received by taxpayers' partnership (Progress) from their supplier (Olympic) for agreeing to the cancellation of the contract under which Progress was entitled to purchase 2,250,000 gallons of gasoline per month from Olympic is taxable as ordinary income under Section 22(a) of the Internal Revenue Code of 1939 (Appendix, *infra*), as the Tax Court held, or as capital gain from the "sale or ex-

change" of property within the meaning of Section 117(a)(4) and (j) (Appendix, *infra*), as taxpayers contend. This question has been decided in the Commissioner's favor in *Commissioner* v. *Starr Bros.*, 204 F. 2d 673 (C.A. 2d); *Commissioner* v. *Pittston Co.* (C.A. 2d), decided February 11, 1958 (58-1 U.S.T.C., par. 9284); *Roscoe* v. *Commissioner*, 215 F. 2d 478 (C.A. 5th); *Appalachian Electric Power Co.* v. *United States* (C. Cls.), decided January 15, 1958 (58-1 U.S.T.C., par. 9196); *McCartney* v. *Commissioner*, 12 T.C. 320. See also *General Artists Corp.* v. *Commissioner*, 205 F. 2d 360 (C.A. 2d), certiorari denied, 346 U.S. 866. The reasoning of these cases is fully applicable here and they are persuasive authority for the position taken by the Tax Court below.

Under Section 117(a)(4) and (j) of the 1939 Code "long-term capital gain" is defined as the gain from the "sale or exchange" of capital assets or of "property used in the trade or business". The Tax Court determined that the rights of Progress, and of taxpayers, under the Progress-Olympic contract constituted "property used in the trade or business" and that determination is not in dispute before this Court. The decisive issue is whether there was a "sale or exchange" of such property when the Progress-Olympic contract was cancelled by agreement of the parties in 1950 and Progress received the sum of $183,330.50 as consideration for such cancellation.

The several courts which have decided the cases cited above are in agreement that in situations such as the one here presented, the cancellation or termi-

nation of the pre-existing relationship of the parties ended the duty of the promisor and destroyed the rights of the promisee. In such case, it may truly be said that the rights of the promisee (Progress) "came to an end and varnished". *Commissioner* v. *Starr Bros.*, 204 F. 2d 673, 674 (C.A. 2d). If the rights of the promisee are thus destroyed, the cancellation or termination of the pre-existing agreement is not a "sale or exchange" of property which would permit the amount received to be treated as capital gain under Section 117, rather than as ordinary income under Section 22(a).

In *Commissioner* v. *Starr Bros., supra*, the taxpayer, a retailer, had entered into a contract with a drug manufacturer (United) under which it was appointed exclusive sales agent for such manufacturer's products in New London, Connecticut. Taxpayer agreed to sell the manufacturer's products at retail at prices not less than those set by the manufacturer. In 1943, the taxpayer received $6,394.57 for the cancellation of this contract and entered into a non-exclusive sales agency contract with the manufacturer. The taxpayer then contended that the cancellation transaction was a "sale or exchange" of property entitled to treatment as capital gain. The Court of Appeals for the Second Circuit, relying on the analogous reasoning employed in *Bingham* v. *Commissioner*, 105 F. 2d 971 (C.A. 2d), and the decision of the Supreme Court in *Hort* v. *Commissioner*, 313 U.S. 28, held that the amount received was properly taxable as ordinary income, stating (p. 674):

> Undoubtedly the taxpayer's rights under the

> 1903 contract were property; and we will assume arguendo, as does the Commissioner, that they were a capital asset. The decisive issue is whether there was a "sale or exchange" of such capital asset when the contract was terminated in 1943. To refer to the contract as a grant of a "franchise" tends, we think, to becloud analysis of the legal relations. What the taxpayer gave in return for the cash payment was *a release of United's contract obligation*, chief of which was its promise not to sell its products to other dealers in New London. Such release not only ended the promisor's previously existing duty but also destroyed the promisee's rights. *They were not transferred to the promisor; they merely came to an end and vanished.*" (Italics supplied.)

More recently in *Commissioner* v. *Pittston Co.* (C.A. 2d), decided February 11, 1958 (58-1 U.S.T.C., par. 9284), the same court reached a like result in a case closely paralleling the present controversy. The taxpayer in *Pittston* had entered into a contract with a coal mining company pursuant to which the taxpayer agreed to purchase and the coal company agreed to sell the entire output of designated mining property. In 1949, in exchange for a payment of $500,000 to the taxpayer, the coal company "acquired" the taxpayer's rights under the previous contract, and the taxpayer contended that this was a "sale or exchange" of property and thus capital gain. Notwithstanding the artful language employed by the parties, the court concluded that the payment was "solely for the termination of the right-duty relationship between the two parties to the agreement" and

determined that the amount received must be taxed as ordinary income.

A similar parallel is also found in *Appalachian Electric Power Co.* v. *United States* (C. Cls.), decided January 15, 1958 (58-1 U.S.T.C. par. 9196), in which the taxpayer and the TVA were parties to a contract under which each agreed to supply the other with surplus electric energy. In 1945, the parties executed an agreement cancelling their prior contract and providing for the payment by TVA to the taxpayer of $180,000 for the remaining years of the earlier contract. The Court of Claims, overruling the taxpayer's assertions that the transaction constituted a "sale or exchange" of property, held that the transaction did not constitute a transfer by taxpayer to the TVA and that the TVA did not thereby acquire the right to supply electric power to itself. The amount received was therefore held taxable as ordinary income, not capital gain. See also *Roscoe* v. *Commissioner*, 215 F. 2d 478 (C.A. 5th), wherein it was determined that the amount received in exchange for cancellation of an exclusive real estate sales agency contract was taxable as ordinary income and was not a "sale or exchange" of property entitled to treatment as capital gain.[2]

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[2] The rationale employed in the *Starr, Pittston, Appelachian* and *Roscoe* cases, *supra,* finds support in the Supreme Court's decision in *Fairbanks* v. *United States,* 306 U.S. 436. There the Court held that the payment and discharge of bonds by the obligor corporation prior to maturity constituted (p. 437) "neither sale nor exchange within the commonly accepted meaning of the words." See also *Bingham* v. *Commissioner,* 105 F. 2d 917 (C.A. 2d), and *Hale* v.

In both the *Pittston* and *Appalachian* cases, *supra*, the courts noted that the contracts involved, if performed as originally agreed, would have resulted in the receipt by the taxpayers of profits which would have been taxable as ordinary income. In their view, the amounts received by the taxpayers pursuant to the cancellation agreements represented nothing more than the earlier receipt of part of that anticipated profit and should therefore be taxed on the same basis, namely, as ordinary income.

The facts of the instant case present fully as persuiasive a situation for a determination that taxpayers, upon cancellation of the Progress-Olympic contract, received the $183,330.50 as ordinary income. Olympic agreed to sell to Progress 2,250,000 gallons of gasoline per month at designated prices pursuant to a contract which expired on January 1, 1951, but was subject to automatic extension from year to year. (R. 25-27.) As in the cases cited, the Progress-Olympic contract did not require Progress or taxpayers to render personal services, nor did it create an employer-employee relationship. In return for the lump-sum payment, taxpayers (Progress) gave Olympic a release of the latter's supply obligations. As the Tax Court held [3] (R. 34):

Helvering, 85 F. 2d 819 (C.A. D.C.), holding that there is neither a sale nor an exchange when the holder of a note surrenders it to the maker upon payment.

[3] The Tax Court agreed with taxpayers that the fact that the cancellation agreement was denominated a "Mutual Termination Agreement" was not determinative. It considered "not only the provisions of the agreement but also the attendant facts and circumstances shown by the evidence." (R. 33.)

> This release not only ended Olympic's duty to supply this gasoline but also destroyed Progress' rights under the Progress-Olympic contract. They were not transferred to Olympic; they "merely came to an end and vanished." Cf. *Commissioner* v. *Starr Bros.*, 204 F. 2d 763, 674 (C.A. 2d).

Furthermore, as in *Pittston* and *Appalachian*, *supra*, the payment received by Progress for the release of its contract right to purchase and resell Olympic's gasoline was in reality but a substitute for the resale profits (ordinary income) which taxpayers would have realized if the contracts had been performed instead of terminated. Had Olympic refused to perform its obligations under the contract, the taxpayer would have been entitled to damages corresponding to the loss of profits occasioned by such refusal. Such damages, representing lost profits, would of course be taxable as ordinary income. The amount received by taxpayers from Olympic for cancelling the Olympic-Progress contract merely took the place of what would have been taxed as ordinary income. *Hort* v. *Commissioner*, 313 U.S. 28. Cf. *Commissioner* v. *McCue Bros. & Drummond, Inc.*, 210 F. 2d 752 (C.A. 2d), certiorari denied, 348 U.S. 829.[4]

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[4] In the *Hort* case, the lessee made a lump-sum payment in exchange for cancellation of the unexpired portion of the lease. The taxpayer-lessor claimed capital gains treatment on the amount received. The Supreme Court held the payment to be ordinary income, stating (pp. 31-32):

> Where, as in this case, the disputed amount was essentially a substitute for rental payments which § 22(a)

The "attendant facts and circumstances shown by the evidence", upon which the Tax Court relied (R. 33), fully support the foregoing analysis. In 1950, when the cancellation agreement was executed, gasoline was in short supply in the Southern California area in which Olympic and Progress were engaged in business and Olympic sought reduction or elimination of its supply commitment under the Progress-Olympic contract. (R. 27.) As taxpayer Leh testified (R. 58), "the shorter the supply position of gasoline, the more profits would be made." Moreover, both taxpayers testified that Progress had claims against Olympic arising out of past deliveries of gasoline. Leh testified (R. 60), "I think I know what the word 'claims' means to me. We had a beef about the prices." He referred to claims against Olympic because of the latter's actions in raising or attempting to raise the price of gasoline. (R. 59-60, 76-77.) Taxpayer Brown characterized these claims as arising from the fact that Olympic was unable or refused to supply the amounts set forth in the supply contract. (R. 107-108.) Significantly, the "Mutual Termination Agreement" provides for the release of Olympic by Progress "of and from any and all duties, claims,

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expressly characterizes as gross income, it must be regarded as ordinary income, and it is immaterial that for some purposes the contract creating the right to such payments may be treated as "property" or "capital".

* * * *

The cancellation of the lease involved nothing more than relinquishment of the right to future rental payments in return for a present substitute payment and possession of the leased premises.

liabilities or obligations" arising out of the contracts between the parties. (R. 27-28.)

These facts led the Tax Court to conclude (R. 33-34) that the cancellation agreement of July 26, 1950—

> was not intended to effect a sale by Progress of its rights under the Progress-Olympic contract to Olympic; that Olympic was desirous of cancelling and terminating those rights; and that the amount of $183,330.50 was paid to Progress in consideration for their cancellation and termination.

It is clear from this evidence that in executing the "Mutual Termination Agreement" taxpayers took into account the profits (ordinary income) to be expected if the Olympic-Progress contract was performed, as well as the claims of Progress against Olympic for loss of profits (ordinary income) under that contract arising from breach of contractual obligations. Such profits, or lost profits, would be taxable as ordinary income and the amount received by taxpayers merely took the place of lost profits and is also taxable as ordinary income. *Hort* v. *Commissioner, supra; Commissioner* v. *Pittston Co., supra; Appalachian Electric Power Co.* v. *United States, supra.*

Taxpayers assert (Br. 15-19) that the Progress-Olympic contract was, in effect, an assignment from Olympic to Progress of Olympic's rights under the General-Olympic contract to the extent of 2,250,000 gallons of gasoline per month and that the "Mutual Termination Agreement" of July 26, 1950, was a transfer of this right from ~~Olympic to Progress~~, for
Progress to Olympic

guished between the cases involving transfers of leasehold interests and those involving releases of ordinary contract rights. It referred to its prior decisions in *Commissioner* v. *Starr Bros.*, 204 F. 2d 673, and *General Artists Corp.* v. *Commissioner*, 205 F. 2d 360, certiorari denied, 346 U.S. 866, and stated (p. 753):

> In these cases no "sale or exchange" within the meaning of the statute was found because the contractual right was not transferred, but was released and merely vanished. However, we think the right of possession under a lease or otherwise, is a more substantial property right which does not lose its existence when it is transferred.

The Fifth Circuit recognized a similar distinction. Its decision in *Commissioner* v. *Ray*, *supra* (involving the surrender of a leasehold interest), was followed by *Roscoe* v. *Commissioner*, 215 F. 2d 478, which held that the amount received for cancellation of an exclusive real estate sales agency contract was taxable as ordinary income under Section 22(a) of the 1939 Code. In *Roscoe*, the court approved the rationale of *Commissioner* v. *Starr Bros.*, *supra*, and *General Artists Corp.* v. *Commissioner*, *supra*. This judicially-drawn distinction forms the basis of an administrative ruling to the effect that the consideration received for a release of simple contract rights, as distinguished from the surrender by a lessee of a leasehold interest, constitutes ordinary income under Section 22(a), Rev. Rul. 56-531, 1956-2 Cum. Bull. 983.

Similarly, in *Commissioner* v. *Goff*, *supra*, a right in specific tangible property, as distinguished from

a simple contract right, was involved. The taxpayer in that case owned some hosiery machines which he installed in a hosiery mill under an agreement obligating the mill to pay a fixed sum per dozen pairs of hosiery for the use of the machines and to sell the output to the taxpayer at a stipulated price. At a later date, the mill paid the taxpayer an agreed sum in exchange for the right to use the machines free of the obligation to pay such use charges. The Third Circuit noted (pp. 876-877) that the right there transferred was "a right connected with the use of specific tangible property, that is, the machines themselves." It distinguished the *Starr Bros.* and *General Artists Corp.* cases, *supra*, on the ground that the contract rights there involved were less substantial.

In *McAllister* v. *Commissioner*, *supra*, the Second Circuit held that the transfer by a life tenant of his life interest to the remainderman for a sum of money was a sale. This case was expressly distinguished by the same court in its later decision in *Starr Bros.*, *supra*, as having been decided under the rule of *Blair* v. *Commissioner*, 300 U.S. 5 (holding that a transfer by a life tenant of a portion of the income for the duration of the life estate rendered the income taxable to the transferee as beneficiary of the life estate to the extent of the transfer).

With all due candor, we cannot state that the decision of the Tenth Circuit in *Jones* v. *Corbyn*, *supra*, is distinguishable. That case involved the release of an exclusive insurance agency contract for a lump-sum payment. The court held that such transaction

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

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MARCH, 1958.

APPENDIX

Internal Revenue Code of 1939:

Sec. 22. Gross Income.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal services, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

Sec. 117. Capital Gains and Losses.

(a) *Definitions.*—As used in this chapter—

(1) [As amended by Sec. 115(b), Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 151(e), Revenue Act of 1942, c. 619, 56 Stat. 798] *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which

is subject to the allowance for depreciation provided in section 23(1), or an obligation of the United States or any of its possessions, or a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer;

* * * *

(4) [As amended by Sec. 150(a)(1), Revenue Act of 1942, *supra*] *Long-term capital gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * *

(j) [As added by Sec. 151(b), Revenue Act of 1942, *supra*] *Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind

which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. * * *

(2) *General rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat of imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 117.)

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